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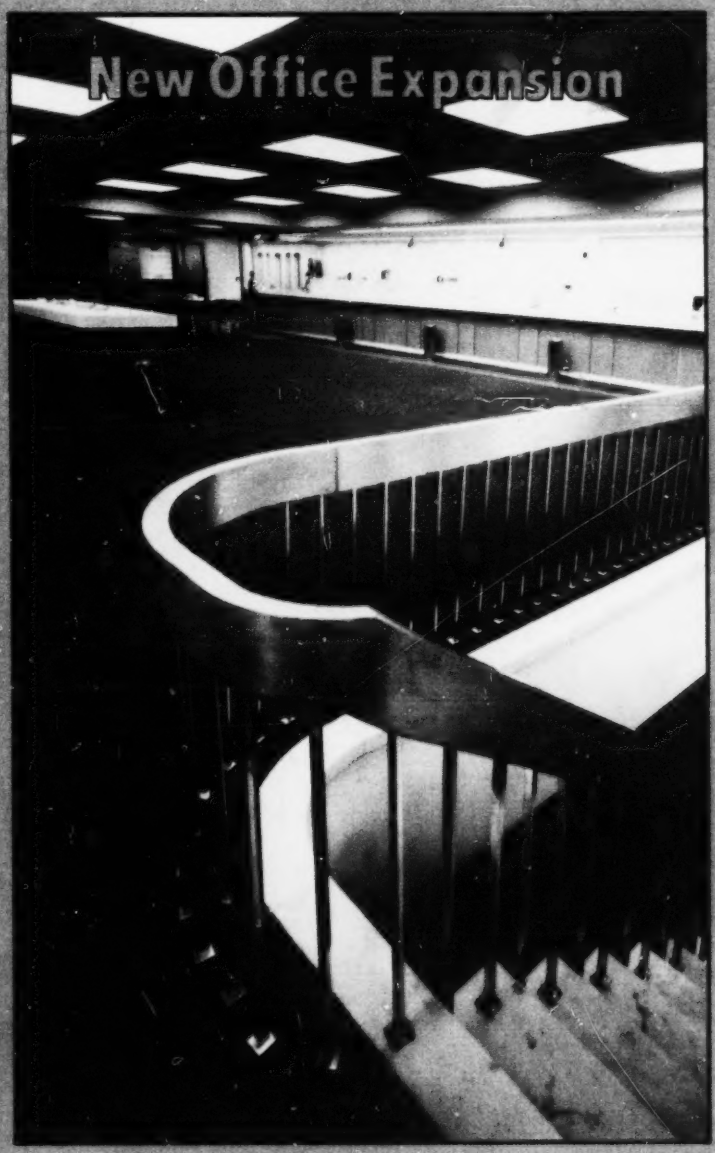

Surprise...New 30-Month CD Clicks With Public

Nondeposit Liability Management

—a look at three short-term tactics ...are they for you?

Increase Pension Services Sales-Push, Savings Bankers Told

Also: Mutual in New York Opts for Federal Charter ■ Usury Preemption Bumps Up Against Credit Crunch ■ NOW Accounts Off to Slow Start in New Jersey ■ Opposition Mounts to Industry's First Federal Charter Application ■ Court Upholds Mutual-to-Stock S&L Conversions ■ Expanded Credit Union Customer Base Upheld ■ Rates Increase, Starts Unexpectedly Rise Slightly

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Savings Bank Journal
February 1980 Volume 60

Nondeposit Liability Management

. . . *in a pressure-laden financial environment*

Nondeposit liability management is a shorthand way to describe a strategy for increasing earnings and liquidity by tapping the short-term money market. . . . And, as the author explains, there is plenty of room for most savings banks to expand their short-term borrowing activities.

THIS YEAR promises to be filled with as many economic and financial uncertainties as was 1979. In such an environment, the successful savings bank will be required to develop a number of alternative operating strategies. Among these, many banks are considering a potential role for short-term open-market borrowings—such as commercial paper, so-called jumbo CDs and securities repurchase agreements—in meeting deposit outflows and bolstering their earnings.

There exists considerable room for savings banks to expand their use of short-term money market borrowings. As of October 1979, external borrowings represented only 2% of savings bank assets. Also, future short-term borrowings by savings banks should be facilitated by anticipated new FDIC regulations which will authorize savings banks for the first time to sell commercial paper. And the recent introduction of independent credit ratings for commercial paper and large certificates of deposit should eliminate any market impediments which, to date, have served to bar savings banks from full participation in the short-term credit markets.

For a number of other reasons, issuing commercial paper and large negotiable and non-negotiable certificates of deposit in national credit markets will deserve further attention by savings banks during what is forecast to be a disappointing 1980. Principally, costs—issuance plus interest—are generally lower for commercial paper and CD issuers who repeatedly tap these sources than are alternative sources of borrowings. However, initial high selling costs will make such sales unattractive to savings banks which plan only infrequent issues or have other sources of borrowing available. Securities repurchase

Table 1 — Reliance on External Borrowings by Mutual Savings Banks and Savings and Loan Associations

(amounts in millions of dollars)

Average for period	Mutual savings banks		Savings and loan associations	
	Amount	Percent of assets	Amount	Percent of assets
1973	$ 264	0.3%	$13,495	5.2%
1974	611	0.6	20,918	7.4
1975	687	0.6	22,597	7.3
1976	478	0.4	19,828	5.5
1977	512	0.4	23,465	5.5
1978	1,108	0.7	30,374	6.2
January-October, 1979	2,456	1.5	46,607	8.4
As of Oct. 31, 1979	3,529	2.2	54,264	9.4

Note: Above data include FHLBB advances and other borrowings for both savings banks and savings and loan associations. As of Sept. 30, 1979, 100 savings banks were members of the FHLB System.

by Philip M. Gabel

The author is the senior economist in NAMSB's Department of Research and Economics; this article is based on a memorandum he presented to the National Association's Asset and Liability Management Committee.

agreements, on the other hand, offer attractive opportunities for savings banks. Relatively cheap sales and interest costs, plus the speed with which these transactions are executed, make repos useful for bolstering earnings as well as in meeting temporary liquidity needs.

In this article, we will briefly set the economic and financial stage savings banks will likely find themselves operating in during 1980. Then, in this context, we'll look at the reliance by savings banks on external borrowings historically, and at the mechanics of savings bank participation in the markets for commercial paper, negotiable CDs and securities repurchase agreements.

Financial Environment

The year 1979 saw record levels of disintermediation at savings banks surpassing the $6 billion mark, excluding interest, and bottom-line earnings dropped by more than one-third from year-earlier levels. All this occurred against a background in which: (1) open-market rates rose above previous peaks set during 1973-74; (2) deposit interest costs soared as a result of escalating six-month CD interest costs and increases in the Regulation Q ceilings; (3) the Federal Reserve, to curb inflation, shifted from controlling the federal funds rate to regulating commercial bank reserves more directly; and (4) the economy began to weaken.

Confronted with this hostile environment, savings banks were increasingly forced to sacrifice earnings so as to meet escalating deposit outflows.

More of the same is forecast for 1980, but only in lesser doses. While the recession should be short, recovery likely will be slow and modest. Interest rates should peak sometime during the first half of the year and then decline moderately so that by year-end the prime rate should be around 10% and mortgage rates in the 10%-11% range.

Disintermediation at savings banks should lessen during 1980, although outflows are still expected to be around $3 billion for the year as a whole. Concerning industry earnings, additions to retained earnings are expected to decline still further, reflecting the continuing unavailability of investment capital and increasing deposit interest costs. Against this background, savings banks have good reason to consider strategies for cushioning the expected 1980 decline in earnings.

Table 2 — Relative Borrowing Costs, Selected Interest Rates

	prime rate	90-119-day prime commercial paper	4-6-month commercial paper	3-month certificates of deposit
1973-74 disintermediation period	9.8%	9.7%	9.6%	N.A.
1975	7.9	6.3	6.3	6.4
1976	6.8	5.2	5.4	5.3
1977	6.8	5.5	5.6	5.6
1978	9.1	7.9	8.0	8.2
1979				
January	11.8	10.3	10.3	10.5
February	11.8	10.0	10.0	10.2
March	11.8	9.9	10.0	10.1
April	11.8	9.9	9.9	10.1
May	11.8	10.0	10.0	10.2
June	11.6	9.8	9.7	10.0
July	11.6	9.9	9.8	10.0
August	12.0	10.4	10.4	10.7
September	12.9	11.6	11.6	11.9
October	14.3	13.2	13.2	13.7
November	15.6	14.4	N.A.	14.0
December	15.0	13.8	N.A.	13.4

N.A. — not available.
Source: Federal Reserve Board and the "Schroder Report."

Historical Pattern of Borrowings

The 1980 forecast suggests a useful role for short-term money market borrowings. Savings banks to date, however, have been reluctant to expand their reliance on external borrowings. As noted earlier, savings bank external borrowings represent only 2% of savings bank assets. This reticence to use short-term credit markets, however, appears consistent with savings bank liability management policies in past high-interest-rate periods. For example, during the 1973-74 period, savings bank borrowings never amounted to even 1% of assets. (See Table 1.)

To a certain extent, legal constraints as well as commercial bank domination of the short-term credit markets have kept savings banks from participating fully in these markets.

On the other hand, savings and loan associations—largely due to the availability of FHLBB advances—have relied far more heavily on external borrowings. As of Oct. 31, 1979, external borrowings represented nearly 9% of S&L assets.

Furthermore, though declining markedly, external borrowings still accounted for between 5% and 6% of savings and loan assets during the more moderate interest rate climate of the mid-1970s. This suggests that even during periods of strong deposit inflows, S&Ls have been able to find productive uses for borrowed funds.

Based on the experience of the savings and loan business, considerable room appears to exist for savings banks to expand their activities in this area. It goes without saying, however, that the availability of FHLBB advances and fewer regulatory impediments on federally chartered savings and loans have been influential in promoting this greater S&L reliance on external borrowings. But, regardless of the reasons, the impact of these borrowings on the savings associations has been favorable. For example, during periods of disintermediation, among savings and loans: securities losses have been smaller; there has been less dependence on commercial bank borrowings; and holdings of liquid assets have been smaller. In addition, from an earnings perspective, over the

entire interest rate cycle, S&L bottom lines have been bolstered by margining high-yielding investments with short-term borrowings.

Commercial Paper

The recent and anticipated savings bank deposit outflows and the potential that apparently exists for expanding short-term borrowings should motivate savings bank management to consider issuing commercial paper during 1980, if FDIC, as is expected, authorizes such sales for savings banks.

Features of commercial paper. Commercial paper is a short-term—usually unsecured—promissory note which has a scheduled repayment date. In addition, other features of commercial paper include the following:

- Maturities which range from five days to nine months, although 30 days is most common. To a great extent, maturities have been determined by provisions of the Securities Act of 1933. This Act, in part, requires that commercial-paper issues with maturities exceeding nine months be registered with the Securities and Exchange Commission. The additional filing requirements associated with SEC registration effectively limit longer maturities.
- Commercial paper is generally issued in denominations of $100,000, although issues with minimum denominations of $250,000, $500,000 and $1 million are not uncommon.
- While yields generally move in relation to changes in the prime rate and federal funds rate, they run significantly below the prime and much closer to the federal funds rate. For example, in 1979 the average yield spread between 90-119-day prime commercial paper and the prime rate was nearly 160 basis points, compared with 10 basis points between commercial paper and federal funds.
- Commercial paper is sold on a discount basis, has no well-developed secondary market and is most frequently sold through New York City brokers, although certain large corporations rely on direct placement for their paper.

Associated interest costs. An obvious advantage of commercial paper is that interest costs on it are lower than on borrowings from a commercial bank at the prime rate plus the costs of maintaining compensating balances. During 1979, the yield spread between commercial paper and the prime rate ranged from a low of 110 basis points in October to a high of 190 basis points in March. These comparisons suggest obvious cost implications for savings banks, some of which are finding that deposit drains must, in part, be met through borrowing from commercial banks and sales of securities. (See Table 2.)

Issuance costs. Of course, selling costs must also be considered when a bank is deciding whether or not to issue commercial paper. Although the experience of individual savings banks may differ, a hypothetical illustration of the selling costs associated with a first-time sale was developed based on discussions with New York investment bankers. It should be stressed once again, however, that the nature of the market and lack of savings bank experience in selling commercial paper make it impossible to develop precise estimates of the costs which would be experienced by every savings bank. Therefore, the illustrations presented here are best used only as indications of the possible range of costs which might be encountered.

In the present example, it is assumed that a bank sells $1 million of 90-day prime commercial paper. And this entire amount is rolled over at maturity continuously for one year at the 1979 average rate for 90-119-day prime commercial paper. Based on these assumptions, first-time selling costs for the commercial paper—fees for the dealer, credit rating agency, etc.—would be in the area of 2.35% of the total amount of paper sold, bringing the first-time issuer's total costs—issuance costs plus interest—to 13.35%. (See Table 3.)

The above illustration demonstrates that despite favorable interest costs,

Table 3 — A Hypothetical Illustration of Interest and Selling Costs Associated With Commercial Paper

Notes: 1. The following illustration was developed based on discussions with New York investment bankers.
2. Dollar amounts cited in the following example are meant to illustrate only the range of potential costs which might be experienced by a savings bank since lack of experience and the nature of the market make it impossible to develop firm estimates.
3. The illustration assumes that a savings bank issues $1 million of unsecured 90-day prime commercial paper. And this amount is continuously rolled over at maturity for one year at the average 1979 rate on 90-119-day prime commercial paper.

	Dollar Amounts	As percent of amount issued
1. Amount sold yielding 11%	$1,000,000	
Total interest costs	$ 110,000	11%
2. Selling costs		
dealer's fees	$ 700[1]	.07%
credit rating	17,000[2]	1.70
paying agent	400[3]	.04
line of credit	5,350[4]	.54
legal fees	N.A.	
Total selling costs	$ 23,450	2.35%
Total interest and selling costs	$ 133,450	13.35%

N.A.—not available.
[1]Dealers fees generally range from 10-18 basis points on the average amount outstanding.
[2]The cost of an initial credit rating will range anywhere from $8,000-$25,000.
[3]Cost of a New York City paying agent is $10 per note sold.
[4]The cost of a line of credit is maintenance of a non-earning compensatory balance equivalent to 5% of the full line. It is assumed that this amount if available to the savings bank would have been invested at the average 1979 mortgage interest rate.

compared to the prime rate, commercial paper may not be the route to go for every savings bank. Including selling costs, first-time issuers are likely to find that, at least initially, high start-up costs make commercial paper more expensive than borrowing at the prime rate. Therefore, unless a savings bank plans a long-term commitment to the commercial paper market, it may be wiser to continue borrowing from a commercial bank.

However, in the case of the repeat commercial paper seller, subsequent sales will be considerably cheaper, in that a full-fledged credit rating examination will not have to be repeated a second time. And elimination of this requirement should reduce selling costs by more than two-thirds, thus making commercial paper cheaper than borrowing from a commercial bank. Moreover, issuance costs may be reduced still further, because some savings banks may have established lines of credit at commercial banks which are going unused. These could be used to back commercial paper issues at no additional cost to the savings bank. Also, selling costs, whether for a first or subsequent issue, will decline as a percent of the total amount issued as the size of the issue increases.

To return to the negative side for a moment. The previous example assumed that the bank received an "A-1" rating from either *Moody's* or *Standard and Poor's*, or one of the other major rating services. If not, related interest costs are likely to be considerably higher than those in the illustration. Also, it was assumed that the commercial paper issue was unsecured rather than secured. Needless to say, selling costs associated with a secured issue would have been considerably higher. Ratings, incidentally, are a relatively new feature for commercial paper. Previously, commercial paper was sold based on the reputation of the issuer, and sellers who were credit worthy, but unknown, frequently encountered significant market resistance.

Another cost aspect to consider vis-a-vis the commercial paper market is that many savings banks may have a cheaper alternative way of borrowing available to them. For example, as of September 1979, 100 savings banks were members of the Federal Home Loan Bank System. And since rates on FHLB advances and commercial paper are generally fairly close, member savings banks—having already incurred the costs of belonging to the system—might choose to avoid commercial paper issuing costs by borrowing from the FHLB.

Although perhaps appearing so far to take a back seat to cost considerations, equally important is the potential role in savings bank earnings of the funds raised from commercial paper sales. Unfortunately, in the present high-interest-rate environment, only high-yielding short-term investments, such as Eurodollars, offer earnings that are significantly above commercial paper selling and interest costs. (See Tables 2, 3 and 4.) During much of 1979 and generally during the middle of the 1970s, however, favorable yield spreads would have made it attractive to margin mortgage investments with commercial paper sales. And in fact, even presently, some savings banks have elected to take short-term losses on their borrowings in order to lock in cyclically high-yielding mortgages. (See Table 4.)

Aside from yields and issuing costs, commercial paper does offer certain other advantages relative to other forms of external borrowing. Among them: the speed with which it can be sold and the issuer's ability to tailor maturities. These features by themselves have been sufficient to reduce the need for a secondary market and increase the potential usefulness of commercial paper in meeting unforeseen liquidity needs.

With the latter advantages and the expected elimination of regulatory impediments, it behooves savings banks to familiarize themselves with commercial paper. A final decision on whether or not to sell commercial paper, however, can only be made when considered in relation to the overall operating objectives of the institution.

Table 4 — Margining Borrowed Funds, Selected Investment Yields

	Federal Funds	3-Month Treasury bills (secondary market)	3-month Eurodollar deposits	Conventional mortgages, Secondary market
1975	5.8%	5.8%	7.0%	9.4
1976	5.1	5.0	5.6	9.1
1977	5.5	5.3	6.1	9.0
1978	7.9	7.2	8.7	10.0
1979				
January	10.1	9.4	11.2	11.1
February	10.1	9.3	10.8	11.0
March	10.1	9.5	10.6	10.9
April	10.0	9.5	10.6	11.0
May	10.2	9.6	10.7	11.4
June	10.3	9.1	10.5	11.6
July	10.5	9.2	10.9	11.5
August	10.9	10.3	11.5	11.5
September	11.4	10.3	12.6	11.8
October	13.8	11.7	14.6	12.8
November	13.2	12.4	15.1	13.7
December	13.7	12.5	14.4	13.0

Source: Federal Reserve Board and the "Schroder Report."

Negotiable Certificates of Deposit

Savings banks have had considerably more experience with direct placements of large non-negotiable CDs than with other forms of short-term borrowings. However, this instrument's usefulness has been limited to a relatively few investors by virtue of its non-negotiability and lack of marketability in distant markets. This obviously has tended to lengthen the time required to raise needed funds through this instrument and reduce the worth of large certificates of deposit as a source of capital.

The role of large certificates of

Nondeposit Liability—

deposit at savings banks, however, could soon change due to the availability, beginning last year, of credit ratings for negotiable and non-negotiable CDs. Negotiable CDs differ from their non-negotiable counterpart in that they are traded in an active secondary market. Also, the introduction of independent credit ratings —whether for negotiable or non-negotiable CDs—should help to overcome the difficulties associated with an unknown issuer attempting to sell his debt in markets distant from his home area.

Except for the secondary market consideration, the negotiable and non-negotiable CD are similar. Both of these instruments:

- Are time deposits on which Regulation Q ceilings do not apply.
- Have an interest rate which fluctuates in relation to other comparable short-term rates. (For example, during 1979, three-month CD interest rates were roughly equal to those on federal funds while being significantly less than the prime rate. In December, these CD rates averaged 13.8%, while the fed funds and prime rates averaged 13.7% and 15%, respectively. See tables 2 and 4.)
- Are sold in minimum denominations of $100,000.
- Pay interest on a bond yield equivalent basis—that is, principal plus interest, compared to commercial paper which is on a discount basis.
- As a rule, have maturities ranging from 30 days to six months, although longer maturities are permissible. A favorite maturity of many savings banks, however, is 30 days.
- Are frequently marketed through direct placements, but as a result of credit ratings they are increasingly being issued through New York dealers.

To date, savings banks have often sold non-negotiable CDs, so as to bolster their earnings by margining high-yielding investments with the lower cost CDs. An additional advantage of non-negotiable CDs: direct placements have enabled issuing banks to minimize selling costs. Savings banks selling either negotiable or non-negotiable CDs in national markets must unavoidably, however, increase selling costs and thus reduce earnings benefits from this type of external borrowing. Despite this, these CD issuance costs, in most instances, will still be less than those on commercial paper, basically because large CDs do not have to be backed by expensive commercial bank lines of credit. But regardless, a basic fact remains: Higher initial CD selling costs will reduce the attractiveness of such sales to the one-time or infrequent seller.

Concerning specific issuing costs, in some cases a bank might be able to sell its CDs without benefit of a credit rating, but for others a rating will be a necessity. This can be significant, according to some banks, because a bank that can do without a rating can expect that its CD issuing costs will drop to as little as five basis points, which would cover brokerage fees. Banks that require a credit rating to sell their large CDs can anticipate costs on a first-time sale approaching 1.8%, assuming a $1 million issue. This will cover the dealer's fee and the credit rating. The second sale, however, will require that only the dealer's fee be paid, assuming no significant time lapse between the

first and second sales, and that the original credit rating continues to be acceptable.

For many savings banks, large CDs have not proven a viable alternative to borrowing from commercial banks in order to meet temporary liquidity needs. This obviously has been due more to the short period in which large amounts must often be raised by these banks, rather than to selling costs. Future sales—assuming a bank is willing to underwrite the initial costs of selling in national markets—are likely to be much quicker and this should offer the possibility of a new employment for the large CD.

Repo Agreements

Of the different forms of short-term borrowings discussed, savings banks have had substantial experience with securities repurchase agreements. Needless to say, execution of a repo involves the temporary sale of securities to an investment banker with a simultaneously executed commitment to repurchase them on a certain date. As a rule, the securities which are sold are either U.S. government or some other high-quality securities. To avoid losses resulting from possible market fluctuations, the selling institution agrees to repurchase its securities at par plus interest.

The investment bankers who buy the repos do not generally warehouse the securities they purchase, but rather sell them to an unrelated third party. The original bank therefore is likely to repurchase different securities from those originally sold. Protection is provided the seller, however, by the fact that he is guaranteed the return of securities comparable to those originally sold.

Repos may have an exact term or carry no specific repurchase date. In the latter case, the repo can be canceled by either party at any time. More often, however, repos are executed for an exact term, one day being the general rule.

What makes a repo attractive to a savings bank is its cost and speed. Selling costs are minimal, basically involving only a brokerage fee, which, incidentally, is included as part of the stated rate. Rates, paid on the repos, as a rule, move in relation to other short-term rates, such as the federal funds rate. For example, in December, rates on repos were in the 12.5% range while the fed funds rate averaged 13.7%. As a general rule, rates on repos fluctuate in a narrow band of ¼ of 1% to 2% below the rate paid on federal funds.

Unlike large CDs, lack of recognition has not closed repo markets to savings banks. Repos are in effect collateralized loans, and the value of the backing securities serves as a substitute for recognition of the issuing bank.

Both large and small savings banks have taken advantage of this access to execute repos, as their cost makes them ideal for margining high-yielding investments. But, in addition, the speed with which a repo can be executed makes it useful for satisfying temporary liquidity needs which occasionally arise.

In summary, the potential obviously exists for savings banks to expand their activities in the area of short-term borrowings. As has been stressed throughout, however, greater involvement can require substantial initial start-up costs, and these can be justified only if the institution can gain access on agreeable terms, and plans to make repeated use of short-term credit markets.

(END)

Aggressive Marketing for Pension Services Urged at Seminar

Savings banks should aggressively seek a larger slice of the $530 billion retirement account pie, and sharpen their competition against insurance companies, savings and loan associations and commercial banks for the full range of pension plan accounts. This was the message delivered to some 125 delegates at a one-day seminar on "Marketing Pension Services," held in New York City, December 14, and sponsored by the Savings Banks Association of New York State.

As one speaker pointed out during the seminar, savings banks—particularly those in New York State—have been offering pension services since the Keogh plan was authorized by Congress in 1962. But, recent data show a slight erosion in the industry position in New York State, and nationally. The 17-state mutual savings bank industry lost 2% of the national IRA/Keogh market shared by financial institutions in 1978; New York State savings banks also dropped 2% in their national market share that year (see table, this page).

Financial Institutions Ira/Keogh Market Share
(amounts in millions of dollars)

	Savings Bank Industry	New York Savings Banks	Savings and Loan Industry	Commercial Banking Industry
Total (12/31/78)	$2,235	$1,570	$5,524	$2,992
Share (1977)	20%	15%	45%	20%
Percent Growth	45%	43%	63%	94%
Attributable Growth	15%	10%	45%	30%
Share (1978)	18%	13%	45%	24%

Source: NAMSB and SBANYS.

The decline came at a time when, according to another speaker, the Keogh and corporate pension services market has proven it will provide relatively low-cost, stable sources of long-term deposits during disintermediation, and when the IRA market remains virtually untapped.

Supporting this call to action, the delegates further were told that retirement accounts should not be considered tax-shelters for the idle funds of the well-to-do; rather they should be looked on as long-term relationships that can provide impetus for service diversification and cross-sell opportunities. Pension services, one speaker reasoned, are very much in line with the purpose for which savings banks were originally founded—thrift and money management, the encouragement of savings for security and for a "rainy day."

To successfully penetrate the pension funds market, the delegates were urged to:

- Diversify their pension services; IRA and Keogh plans account for only 3% of the pension market, yet these are the only two services savings banks have been concentrating on in marketing efforts.
- Assign marketing and administrative responsibilities for pension services, develop sales training programs, and design products that are keyed to specific customer needs and market segments.

In opening remarks to the seminar, Frank A. Dellomo, executive vice president, The Brooklyn Savings Bank, New York City, and chairman of SBANYS' committee on financial and marketing analysis, claimed that the more than $2 billion of New York savings bank pension accounts "does not even scratch the tip of the iceberg in market potential." Relative to market potential, the seminar audience was informed that approximately one-half of the U.S. work force, some 46 million people, are

(continued on page 48)

Pension Seminar—

not covered by pension plans. In the area of corporate accounts, nationally there are some 10 million unincorporated businesses, with 975,000 firms employing less than 100 people.

Continuing, Dellomo cited the $329 million increase in IRA and Keogh deposits that New York State savings banks experienced in the first half of last year as "dampening the otherwise $1.8 billion outflow in other deposits" (see chart, page 49). Over 450,000 pension accounts are held by SBANYS' reporting member banks.

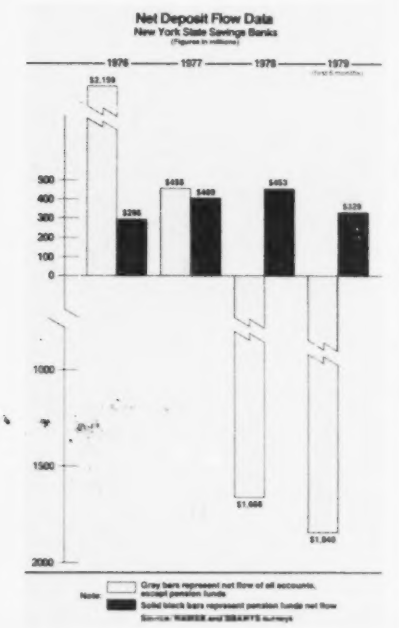
Drawing on his own institution's experience, Dellomo advised savings bankers to "actively research their pension services market and customer, particularly the needs of those commercial bank and corporate customers who keep pension funds on deposit in trust accounts. This active research also must be extended beyond the individual institution to find out what other banks are providing their corporate pension trust depository customers," he suggested.

"Several years ago," Dellomo said, "Brooklyn Savings did research the corporate pension trust depository market to learn what other banks were doing to serve these accounts. And it was shocking for us to see how antiquated some of their pension service systems were—with manual accounting, hand-posting, and even the writing of checks and customer statements by hand." As a result, Dellomo said, Brooklyn Savings designed its pension services program around its bank computer. "We found out what kind of service the customer wanted and needed, and we provided it. Active marketing research showed the way."

Similarly, another seminar speaker, Douglas Vergith, assistant vice presi-

dent, Schenectady (N.Y.) Savings Bank and chairman of SBANYS' bank operations advisory committee on pension services, pointed out that savings banks have a wide variety of plans and account services to offer both the consumer and the corporate customer.

In addition to the seasoned IRA and Keogh plans, he said, there is the new Simplified Employee Pension Plan (SEPP) which bridges both markets. "This plan is still so new," Vergith said, "that we do not yet have any feeling for a true level of potential savings bank participation in the SEPP program, except that a number of



banks have expressed interest in the association's prototype of the plan." SEPP allows employers, both corporations and unincorporated businesses, to make tax-deductible contributions to IRAs for employees in an amount not exceeding the lesser of 15% of annual compensation, or $7,500 per year."

Among various corporate pension services, Vergith cited the profit sharing and thrift incentive plans available through savings banks. These, he said, allow employers to tailor a plan to their own needs through contributions out of net profits based on the employee's personal contributions, or through a preselected formula approach to contributions, or combinations of both. "A significant move was made in the area

(continued on page 50)

Pension Seminar—

of corporate pension plans last year," Vergith said, "when the maximum annual contribution limitation for an employee was increased to the lesser of $32,500 or 25% of annual compensation. The employer's annual deduction is limited to 15% of total compensation of all participants," he explained.

And, savings banks have taken advantage of powers to act as a pension trust depository. "At the end of April 1979, New York State savings banks held over $300 million worth of corporate pension deposits in a variety of accounts," Vergith said.

Later in the seminar program, SBANYS' Robert Quinlain, assistant director of bank services, would say this $300 million figure is a low estimate. "I suspect," he said, "that this figure is seriously understated because a significant number of large savings banks do not accurately and regularly monitor the amounts of their corporate deposits." Quinlain suggested that banks "rethink their management information system reports and structure them to analyze net deposit flows by product type—IRA, Keogh, or corporate services."

The structure of savings bank pension accounts was emphasized by another speaker, Carlos Naudon, the association's director of financial and marketing analysis. Citing data from a SBANYS' pension account survey, he said, "savings banks, whether by design or as a result of competitive forces, have primarily engaged in a retail level of pension service activity, serving the IRA customer, while the competition has made significant inroads on the wholesale, or Keogh and corporate sides."

Keogh and corporate pension services attract less volatile, longer-term deposits, Naudon said, in noting withdrawal rates of 4% for Keoghs in 1978 compared with 7% for IRAs. In addition, Keoghs registered a higher average account balance during the year than IRAs.

Using data from the Federal Reserve's Functional Cost Analysis, Naudon compared transaction volume and the costs for regular savings and time certificates and drew an analogy between these two services and IRAs and Keoghs. "Regular savings accounts are substantially more expensive to maintain (about $35 per year) than time certificates (about $10 per year)," he said. "More importantly, the volume of dollars generated by regular savings is significantly less than is obtained through time certificates. This is particularly evidenced by the fact that three out of four regular savings accounts are very low-balance accounts." Continuing, he said, "Available data indicate that IRAs have the same transaction levels as regular savings accounts. Keogh and corporate accounts, however, have less transactions and more closely reflect time certificates. The inference to be drawn here is that because IRAs and Keoghs both usually pay 8% interest, IRAs are substantially more expensive than the wholesale-oriented Keogh and corporate plans."

While Naudon stressed the value of developing the Keogh market, SBANYS' Quinlain in his presentation emphasized the untapped resource of IRAs. Quinlain reported that "from the latest data from the U.S. Department of Treasury (1977), less than 5% of the eligible IRA plan customers have actually opened an IRA. New York savings banks now hold over $1 billion in IRA accounts. What deposit impact would there be if the percentage of IRA holders jumped from 5% to 25% or 40%?"

Part of the unrealized market for IRAs, Quinlain said, is in the middle-income bracket, and he explained, "Less than 10% of all current IRA holders earn less than $20,000 a year, and of those who earn more than $50,000 a year, 50% have IRAs."

For workers earning up to $20,000 a year, "our industry's degree of success has been most disappointing, since our market is some 60 million taxpayers," Quinlain said.

In addition to providing low-cost, long-term, stable sources of funds and new products for the savings bank services portfolio, pension accounts also can provide a route to savings bank diversification, according to speaker Ross B. Kenzie, president of the Buffalo (N.Y.) Savings Bank. Kenzie, former executive vice president of Merrill Lynch, drew a parallel between the need for service diversification that brokerage houses faced in the mid-1970s and the similar need savings banks now face.

In this context, he said, "for savings banks, diversification must involve an extension of their traditional role as thrift institutions, to enable them to fulfill an individual's personal financial needs. One of the areas definitely well-

suited to the savings ethic and the image of 'people banking' is financial management."

Kenzie pointed out that, currently, commercial banks, trust services, brokerage houses, and attorneys are filling customer needs for financial management services. "But, the ultimate expansion of such products as our IRA/Keogh programs into pension trust services is one way savings banks may fill this need."

However, these pension fund products and services must be "sold," the seminar audience heard from Leonard S. Simon, executive vice president, Community Savings Bank, Rochester, N.Y., who concentrated on the "pros and cons" of the product manager concept within the development of a pension services program.

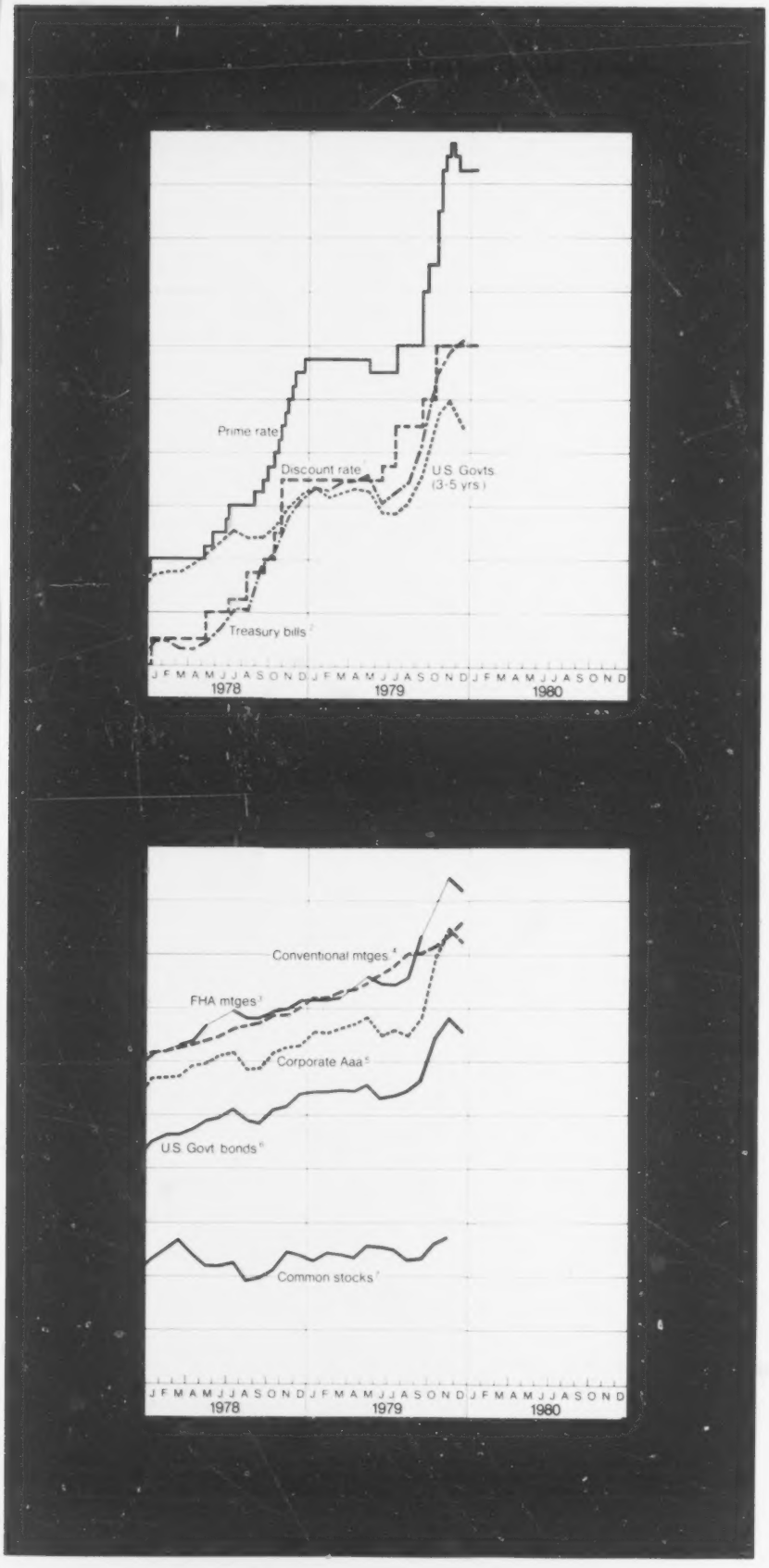
Whether the product manager concept is applied to pension services, or to any financial institution product, there are certain inherent advantages and disadvantages to the approach, he said. Among the advantages Simon cited are: timely reactions to competitive moves; input to the marketing process better harmonized to the advantages of each product presented to the public; appropriate attention given to "less important" products; training and testing ground for future management; and a better opportunity for incentive compensation, either as promotion or wage increases.

For example, Simon explained that the product manager's position would enable the institution to better differentiate cross-sell opportunities and consumer services associated with the IRA from the dollar advantages of the Keogh and corporate services.

Among the disadvantages of the concept, Simon listed: potential for confusion in authority; parochialism, where the product manager does not develop a broad view of the bank and its goals and only concentrates on a narrow functional area; and over-specialization.

"If there is no clear-cut authority for who has the final say—for instance, between a product manager and the advertising manager—then a lot of problems are going to wind up on the marketing vice president's desk that should not be there." Many companies and financial institutions using the product manager concept will place final authority and responsibility for product decisions with the product manager, he said. Simon added that using product managers could become costly, if a large support staff is needed, and if the whole range of products offered are to have managers. "The question is," he said, "how small a product (in importance) should get this kind of specialized attention."

Certainly, pension services qualify for the treatment, Simon asserted. "Because these products require the integration of many different areas of expertise—legal, operations, marketing, investment—and the product manager can act as a coordinator. Also, there is a separate and distinctly defined market target group; necessary record-keeping is readily feasible; and the need of pension services and the pension services market for specialized attention is great—all argue well for using product managers," he concluded.


Prime rate
Discount rate
U.S. Govts. (3-5 yrs.)
Treasury bills[2]
J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O N D
1978
1979
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Conventional mtges.[4]
FHA mtges.[3]
Corporate Aaa[5]
U.S. Govt. bonds[6]
Common stocks[7]
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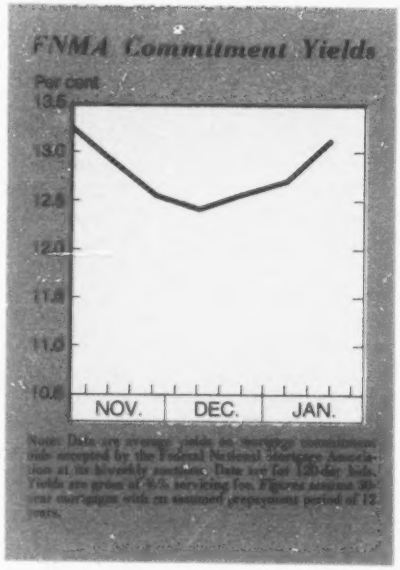
FNMA Commitment Yields
Per cent
13.5
13.0
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DEPOSIT ACTIVITY IN REGULAR ACCOUNTS IN MUTUAL SAVINGS BANKS,[1] BY STATES

(Amounts in thousands of dollars)

State	November 1979					November 1978				
	Amounts Deposited[2]	Withdrawals	Net Change in Deposits			Amounts Deposited[2]	Withdrawals	Net Change in Deposits		
			Excluding Interest	Incl. Interest				Excluding Interest	Incl. Interest	
				Amt.	%				Amt.	%
Connecticut	908,947	943,833	—34,886	34,121	.27	727,680	674,995	52,685	104,911	.88
Indiana	11,659	11,818	—159	—113	—.05	5,303	6,563	—1,260	—1,260	—.60
Maine	211,550	214,892	—3,342	10,201	.44	132,906	136,609	—3,703	5,601	.26
Maryland	96,914	94,591	2,323	9,406	.63	58,693	63,320	—4,627	—869	—.06
Massachusetts	1,886,077	1,993,490	—107,413	6,931	.03	1,344,174	1,460,128	—115,954	—13,339	—.07
New Hampshire	227,302	246,505	—19,203	—7,029	—.30	174,894	182,167	—7,273	4,484	.20
New Jersey	603,947	617,436	—13,489	31,317	.39	450,577	481,437	—30,860	3,287	.04
New York—City	2,975,484	3,417,427	—441,943	—389,993	—.72	2,690,546	2,622,903	67,643	99,471	.18
—Upstate	1,515,060	1,559,364	—44,304	23,061	.11	1,022,833	1,003,245	19,588	61,143	.29
Pennsylvania	1,049,222	1,126,187	—76,965	—31,573	—.27	904,387	903,837	550	35,428	.32
Rhode Island	125,896	125,611	285	5,582	.36	92,329	96,228	—3,899	—299	—.02
Vermont	49,012	54,352	—5,340	—2,858	—.37	40,938	50,933	—9,995	—8,407	—1.17
Washington	336,161	357,137	—20,976	—19,137	—.52	247,424	251,346	—3,922	49	*
Wisconsin	5,511	5,651	—140	—22	—.03	3,114	3,363	—249	—191	—.27
All other states	228,510	227,938	572	4,648	.20	165,618	183,462	—17,844	—15,345	—.73
Total	10,231,252	10,996,232	—764,980	—325,458	—.23	8,061,416	8,120,536	—59,120	274,664	.20

Note: See notes to "Assets and Liabilities of All Mutual Savings Banks." [2] Excludes interest credited. *Less than .005%

[1] Excludes special purpose accounts such as checking, Christmas, vacation and school. Source: National Association of Mutual Savings Banks.

DEPOSIT ACTIVITY IN REGULAR ACCOUNTS IN MUTUAL SAVINGS BANKS

(Amounts in millions of dollars, accounts in thousands)

Period	Amounts Deposited	Withdrawals	Net change in deposits			Number of accounts	
			Excluding interest	Including interest		Total	Net Change
				Amt.	%		
Annually							
1975	53,125	48,369	4,757	11,070	11.27	26,284	980
1976	62,429	57,147	5,283	12,269	11.23	27,533	1,151
1977	73,306	70,431	2,874	10,687	8.76	28,825	1,303
1978	91,967	92,558	—591	7,697	5.80	30,472	1,647
Monthly							
1978—Dec.	9,115	9,520	—405	1,213	.87	30,472	217
1979—Jan.	12,303	12,421	—118	218	.15	30,661	190
Feb.	7,179	6,837	342	682	.48	30,797	135
Mar.	9,350	8,887	463	1,972	1.39	30,871	74
Apr.	10,196	11,388	—1,192	—818	—.57	n.a.	n.a.
May	9,007	9,348	—341	61	.04	n.a.	n.a.
June	9,691	10,340	—649	890	.62	n.a.	n.a.
July	12,494	13,208	—714	318	.22	n.a.	n.a.
Aug.	9,825	10,329	—504	—112	—.08	n.a.	n.a.
Sept.	8,920	9,991	—1,071	484	.34	n.a.	n.a.
Oct.	12,692	14,112	—1,420	—1,031	—.71	n.a.	n.a.
Nov.	10,231	10,996	—765	—325	—.23	n.a.	n.a.
Dec. (Est.)	n.a.	n.a.	—950	800	.56	n.a.	n.a.

n.a.—not available. Est.—estimated.

Notes: Annual and monthly data for net change in deposits including interest and net change in number of accounts have been adjusted where necessary, to exclude the effects of conversions and consolidations of savings banks and other types of institutions. Amounts deposited and withdrawals include shifts of funds between ordinary and time and other higher-yield accounts. Components may not add to totals due to rounding. Source: National Association of Mutual Savings Banks.

ASSETS AND LIABILITIES OF ALL MUTUAL SAVINGS BANKS

(Amounts in millions of dollars)

Date	Mortgages	GNMAs	Investments				Other assets	Total assets-Total liabilities & gen. res. accts.	Deposits			Other liabilities	General reserve accounts
			U.S. Govt. & Federal agencies	State & local Govt.	Corporate bonds	Corporate stocks			Total*	Savings	Time		
1975 Dec. 31	77,221	3,367	7,507	1,545	17,536	4,322	9,558	121,056	109,873	69,653	39,639	2,755	8,428
1976 Dec. 31	81,630	5,808	9,109	2,417	20,335	4,381	11,131	134,812	122,877	74,535	47,426	2,884	9,052
1977 Dec. 31	88,195	8,331	9,233	2,828	21,498	4,751	12,450	147,287	134,017	78,005	54,739	3,292	9,978
1978 Dec. 31	95,157	10,021	8,297	3,333	21,566	4,807	14,991	158,174	142,701	71,816	69,354	4,565	10,907
1979 Jan. 31	95,552	10,230	8,178	3,328	21,622	4,815	15,167	158,892	142,879	69,244	72,145	5,032	10,980
Feb. 28	95,821	10,492	8,114	3,167	21,665	4,837	15,983	160,078	143,539	68,817	73,254	5,485	11,054
Mar. 31	96,136	10,669	8,187	3,126	21,767	4,849	17,132	161,866	145,650	68,829	75,213	5,048	11,167
Apr. 30	95,900	11,011	8,193	3,326	21,331	4,869	16,602	161,231	145,096	67,758	75,452	5,050	11,084
May 31	96,239	11,168	8,148	3,264	21,249	4,887	16,426	161,380	145,056	67,577	75,694	5,172	11,153
June 30	96,743	11,230	8,029	3,175	21,174	4,877	16,586	161,814	146,057	68,104	76,057	4,545	11,212
July 31	97,238	11,275	7,992	3,154	20,994	4,902	17,042	162,598	145,757	67,537	76,306	5,577	11,264
Aug. 31	97,259	11,341	7,921	3,149	20,924	4,861	17,933	163,388	145,713	66,733	76,998	6,350	11,324
Sept. 30	97,973	11,422	7,891	3,150	20,835	4,819	17,341	163,431	146,252	65,676	78,572	5,791	11,388
Oct. 31	98,304	11,611	7,750	3,100	20,818	4,781	16,770	163,133	145,096	62,672	80,591	6,600	11,437
Nov. 30	98,610	11,626	7,754	3,003	20,647	4,763	16,802	163,205	144,828	61,156	81,908	6,872	11,504
Dec. 31 (Est.)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	145,728	n.a.	n.a.	n.a.	n.a.
% of Total Assets													
November 30, 1979	60.4	7.1	4.8	1.8	12.7	2.9	10.3	100.0	88.7	37.5	50.2	4.2	7.0
Change during month	300	32	20	—80	—188	—15	—60	8	—419	—1,522	1,196	357	71

Note: Balance sheet data beginning with April 30, 1979 are not strictly comparable with prior months. This largely reflects: (1) changes in FDIC reporting procedures; and (2) reclassification of certain items.

n.a.—not available. Est.—estimated. Source: National Association of Mutual Savings Banks.

* — Total deposit figures include checking, school, club and certain other accounts not shown separately.

Note: GNMA figures refer to all types of mortgage-backed securities guaranteed by the Government National Mortgage Association.